

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company	:	
	:	00-0260
Annual Rate Filing for	:	
Noncompetitive Services Under an	:	
Alternative Form of Regulation	:	

ORDER

I. INTRODUCTION

By the Commission:

On October 11, 1994, pursuant to Section 13-506.1 of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 et. Seq., the Illinois Commerce Commission ("Commission") entered an Order in Dockets 92-0448/93-0239 Consolidated ("Order"), which established an alternative form of regulation for the noncompetitive services of Illinois Bell Telephone Company ("Ameritech, Illinois Bell or IBT"). Under the terms of the alternative regulation plan adopted, rates for noncompetitive services are tied to an index. Illinois Bell is required to make an annual filing on, or before, April 1st of each year which, inter alia, proposed for Commission approval, a Price Cap Index ("PCI") to be effective on July 1st of the same year. On March 31, 2000, Illinois Bell submitted its sixth Annual Rate Filing in compliance with the Order. The Commission takes administrative notice of the Order and record in Dockets 92-0448/93-0239, Docket 95-0182, (the first Annual Filing), Docket 96-0172 (the second Annual Filing), Docket 97-0157 (the third Annual Filing), Docket 98-0259 (the fourth Annual Filing), and 99-0185 (the fifth Annual Filing).

At a status hearing on April 20, 2000, the Hearing Examiner established a schedule for the filing of initial and reply comments. No subsequent hearings were held in this matter in accordance with the Commission's practice in these dockets in previous years. Petitions to Intervene filed on behalf of Illinois Public Telecommunications Association, AT&T Communications of Illinois, Inc., Citizens Utility Board ("CUB"), and the People of the State of Illinois by the Attorney General of the State of Illinois ("AG"), were granted by the Hearing Examiner. Comments to the Annual Rate Filing were filed by Staff and jointly by CUB/AG. Reply Comments were filed by IBT. Brief on Exceptions were filed by Staff, CUB/AG and IBT. A Reply on Exceptions was filed by IBT. A Hearing Examiner's Proposed Order was served on the parties.

The alternative form of regulation ties rates for noncompetitive services to an index and, thereby supplants the IBT's typical rate case with a more streamlined process with which price changes can be approved. The process consists of an annual filing made by IBT and requires subsequent approval by the Commission of the proposed price cap index, to be effective on July 1 of the year of the filing. Pursuant to Commission Order the PCI must be recalculated once each year according to the following formula:

$$PCI_t = PCI_{t-1} [1 + (\% \text{ change in the GDPPI})/100 - .043 + Z + Q]$$

where:

PCI_t = price cap index for current year,
 PCI_{t-1} = price cap index for previous year,
 $GDPPI$ = Gross Domestic Product Price Index,
 Z = exogenous change factor, and
 Q = quality of service component, which is negative.

Additionally, pursuant to the Order, most of IBT's noncompetitive services have been separated and placed into four distinct customer groups or service baskets. They are as follows: 1) Residential Basket, 2) Business Basket, 3) Carrier Access Basket and 4) Other Services Basket. The prices for the services within each of these baskets are allowed to fluctuate over time such that each basket's Actual Price Index ("API") never exceeds the PCI. The requirement that API for the baskets are less than PCI has placed the emphasis of IBT's annual filings on the calculation of the PCI and the justification of each of its inputs.

Each basket's API is nothing more than a reflection of the basket's average price once demand and any proposed tariff changes are properly accounted for. The API may change at any time during the year when price changes are made. (Order, Appendix A at 3). The API for an individual basket is calculated as follows:

$$API_t = API_{t-1} * \sum_{i=1}^n v_i \frac{P_i(t)}{P_i(t-1)}$$

where:

API_t = actual price index for the current year,
 API_{t-1} = actual price index for the previous year,
 i = rate element i ,
 $P_i(t)$ = proposed price for the i_{th} element,
 $P_i(t-1)$ = current price for i_{th} element, and
 v_i = revenue weight for i_{th} element.

In order to develop a record which the Commission can use to determine whether it should approve IBT's annual rate filings with or without modifications, the Commission

has established a very specific set of filing requirements. In its Order, the Commission stated:

Illinois Bell shall be required to make an annual rate filing no later than April 1 of each year of the plan after 1994. At that time, Illinois Bell shall provide the following information:

- (a) the price cap index for the following 12-month period (July to June), with supporting data showing the GDPPI for the previous calendar year and the percent GDPPI change for that 12-month period;
- (b) the actual price index ("API") for each service basket, including the effects of proposed rate changes under the price cap index for the following 12-month period (July to June) and adjustments for new services added, existing services withdrawn, and services reclassified as competitive or noncompetitive;
- (c) tariff pages to reflect revised rates;
- (d) supporting documentation demonstrating that any proposed rate changes are consistent with the requirements of the price index mechanism;
- (e) a demonstration that Illinois Bell would be in compliance with Sections 13-507 and 13-505.1 of the Act if the proposed rate changes went into effect;
- (f) an identification of any changes to the GDPPI weights and an assessment of the effects of such changes, and any necessary modifications to the PCI;
- (g) the current data showing the calculation of Z for the previous calendar year, with the events causing Z to change identified and described;
- (h) the current data showing the calculation of Q for the previous calendar year, with the events causing Q to change identified and described.

(Order at 92). Furthermore, the Commission stated that "Staff and all of the interested parties will have an opportunity to file written comments in response to each annual filing and the Company will have an opportunity to file reply comments." (Id. at 93).

In accordance with the Commission's filing requirements, IBT submitted its sixth annual filing on March 31, 2000. In its filing, IBT provided: (1) a calculation of the PCI; (2) a demonstration that each of the individual baskets' API would be less than, or equal to, the recalculated PCI (assuming the draft tariff pages are approved by the Commission); and (3) a summary of the analyses that purportedly verify compliance with Sections 13-507 and 13-505.1 of the Act.

A primary and reoccurring issue with IBT's annual filings, while IBT remains under the Plan, is the calculation of the PCI. IBT's filing contains the following calculation for the 1999 - 2000 PCI:

$$\begin{aligned} \text{PCI}_t &= 88.70 * [1 + .0202 - .043 - 0 - 0] \\ \text{PCI}_t &= 88.70 * [.9772] \\ \text{PCI}_t &= 86.68 \end{aligned}$$

Exhibits 1 through 3 of IBT's filing contain the calculations of certain inputs to the PCI formula. Specifically, Exhibit 1 contains the IBT's calculations for the percentage change in the GDPPI, Exhibit 2 presents IBT's quality of service results for 1999, and Exhibit 3 presents any proposed exogenous change. IBT seeks no exogenous change factor in this filing. Based upon IBT's assumptions, the proposed PCI for the period between July 2000 and June 2001 would be 86.68.

II. GROSS DOMESTIC PRODUCT PRICE INDEX ("GDPPI")

A component of the PCI is the Gross Domestic Product Price Index, ("GDPPI"). The GDPPI is used to measure the annual economy wide inflationary change that has occurred in a given time period. GDPPI is published by the Bureau of Economic Analysis, U.S. Department of Commerce ("BEA"). The BEA rebenchmarked the GDPPI data series and issued a new Fixed Weight = 1996 series ("New Series") benchmark. The New Series replaces the previous benchmark of 1992 ("Old Series"). Pursuant to the Commission's order in Docket 99-0185 the New Series information was used by IBT, specifically, New Series data for the 4th quarter of 1998, (103.9) and the New Series estimated 4th quarter 1999, (106.0). Staff agrees that IBT has used the correct GDPPI data in this filing. Consequently, Staff has recommended that IBT's calculation of PCI for the period between July 2000 and June 2001, or 88.68, be utilized in this matter.

Staff however, does propose alternatives to be implemented in future annual filing proceedings. Staff's alternatives are intended to address the situation where GDPPI data for a specific time period is revised by the BEA from the time the data is used in one annual filing to when the data is used in subsequent filings in years when there is not a benchmark change. Staff states that its proposals are contained within the order entered in Docket 98-0185. One clearly defined proposal is that when Ameritech uses a preliminary estimate for the ending GDPPI year, that the same preliminary estimate be used as a starting point in the following year. In the alternative Staff proposes a true-up of the GDPPI factors so that the actual change in inflation is accurately measured.

CUB/AG argue that IBT should utilize the most currently available GDDPI data. Here CUB/AG contends that the most currently available GDDPI for the 4th quarter 1998 is 104.2. The origin of the CUB/AG figure (104.2) is from the BEA web site. The date of this information is April 28, 2000, effective March 30, 2000. The 4th quarter 1998 GDPPI employed by IBT in this filing was 103.9. IBT bases its data on a BEA publication, with an effective date of February 25, 2000. By applying the 4th quarter 1998 GDPPI data, effective March 30, 2000, CUB/AG contend that the PCI would be calculated as follows:

$$PCI_t = 88.70 * [1 + .0173 - .043 - 0 - 0]$$

$$PCI_t = 86.42$$

COMMISSION CONCLUSION

As in past filings, the Commission is confronted with issues relative to the compilation of PCI and the use of data in determining a correct GDPPI value. The Commission has previously recognized that the U.S. Department of Commerce does not generally release its final GDPPI estimates in sufficient time for IBT to provide its annual filing by the first day of April. As such, the Commission in Docket 97-0157 ordered that IBT use the most recent current data which is available from the Department of Commerce prior to March 18 of each year. CUB/AG's revision of PCI and the implementation of data effective after March 18 is rejected. Accordingly, IBT's methodology, which Staff concurs is correctly applied in this particular docket, is accepted.

We reject at this time Staff's alternative proposals regarding a different use of BEA GDPPI data in future proceedings as being premature. Staff agrees that the calculations used by IBT in this proceeding are correct. Because the calculations used in this filing are correct it is not necessary to speculate or suggest the implementation of alternative methodologies for future proceedings. The methodology used by IBT herein is consistent with our determination in 99-0185 and is therefore accepted.

III. CALCULATION OF THE API OF EACH BASKET

IBT has provided information in this filing to calculate the new API values for each basket. The table below shows IBT's proposed Old API, the proposed revenue, the current revenue, and new revenue for each basket. According to IBT's calculations, each basket's API is less than the PCI of 86.68 for this filing.

	<u>Old API</u>	<u>Proposed Rev</u>	<u>Current Rev</u>	<u>New API</u>
Residence Services	88.6981	\$526,175,514	\$538,439,351	86.6779
Business Services	88.6838	\$18,335,841	\$21,730,651	74.8294
Carrier Basket	69.1515	\$203,155,331	\$203,441,863	69.0541
Other Services	88.6693	\$583,345,720	\$596,745,789	86.6782

Staff contends that the Old API values for the Business Services Basket, Carrier Access Basket, and Other Services Basket used by IBT are incorrect. The table below uses the Old API values that Staff believes should be used.

	<u>Old API</u>	<u>Proposed Rev</u>	<u>Current Rev</u>	<u>New API</u>
Residence Services	88.6981	\$526,175,514	\$538,439,351	86.6779
Business Services	88.6996	\$18,335,841	\$21,730,651	74.8428
Carrier Basket	70.6025	\$203,155,331	\$203,441,863	70.5031
Other Services	88.6953	\$583,345,720	\$596,745,789	86.7036

Staff reasons that its Old API values are the correct values to be utilized as they were the API values approved in Docket 99-0185. Staff argues that it is important that New API values be correct in any given file year because they will be used again for the next year's API calculation. In Staff's opinion, this year's New API will become next year's Old API, barring any changes to a basket.

Under either IBT's calculations or Staff's, the New API for Residential Services basket is the same, 86.6779. Differences between IBT's and Staff's New API do occur in each of the remaining baskets.

Under Staff's methodology, while comparing the New API with the PCI, each of the baskets still passes, with the exception of the Other Services Basket. The Other Services Basket New API is 86.7036, which is greater than the PCI of 86.68, and therefore Staff would require further rate reductions for this basket. Staff has calculated that the Company must reduce proposed revenue in the Other Services Basket by an additional \$158,955.98 so that the New API is equal to 86.68 and therefore compliant.

CUB/AG does not reject the Old API values used by IBT. However, CUG/AG's analysis of the baskets is predicated on the use of an incorrect PCI.

IBT opines that the Old API values used in this analysis are not necessarily the values found in the year's annual filing as the API may change at any time during the year when price changes are made. IBT argues that the starting point for the annual filing is based upon the last actual filing made during the previous year. IBT contends this process was followed in all previous annual filings. With respect to the Carrier Basket, IBT contends that its Old API of 69.1515 should be used. IBT suggests that the API for the Carrier Basket was modified when it made its July, 1999, filing and modified subsequently because of reductions required by the price cap formula. With respect to the Business Basket, IBT contends that its Old API value of 88.6838 is correct. IBT argues that the API based upon the actual filing of July, 1999 should be the starting point used herein. With respect to the Other Services Basket, IBT contends that its Old API value of 88.6693 is correct. IBT argues that the API based upon the actual filing of July, 1999, 88.6693, should be the starting point used herein.

COMMISSION CONCLUSION

The issue presented herein occurs when making a comparison analysis between PCI and the New API. The issue is whether the Old API value used in the analysis should be the New API value utilized in the previous year's annual filing or whether the Old API should be the last actual value used in the previous year. As stated hereinbefore, the API may change at any time during the year when price changes are made. (Order, Appendix A at 3). IBT did not provide proof of any such changes in its initial comments, therefore Staff assumed that there were no changes to the API and that IBT must have submitted its values in error. Originally, Consequently, Staff proposed the use of the previous year's annual filing API as the Old API in this filing. IBT's methodology of using the last actual API value of the previous year is accepted. IBT did provide documentation substantiating the proof of changes to the API in its reply comments, which show that the values it submitted in the initial comments were appropriate. After reviewing the supporting documents in IBT's reply comments, Staff concurred with IBT and agreed that IBT's methodology was correct. Therefore, the Commission accepts IBT's calculations of the API for the current year.

In future filings, IBT shall provide documentation of the changes to the API that occur during the course of the year and shall do so in its initial comments. The information/documentation should take a form similar to Attachment 4 of IBT's reply comments. IBT shall also include the recalculation of the proposed and current revenue for each time the API changes over the course of the year, similar in form to Exhibit 5 of its initial comments.

IV. SERVICE QUALITY & EXOGENOUS CHANGE FACTOR (Z)

Two additional factors in computing PCI are, Service Quality and Exogenous Factor ("Z"). IBT, in its filing lists the eight service quality benchmark measurements selected in Docket 92-0448 and compares them to its 1999 results. IBT reports that it has met all benchmarks. Staff notes that this is the first time IBT has met the "lines out of service for a period of time longer than 24 hours" benchmark. CUB/AG request the ability to amend its comments on this issue as they contend IBT has not answered a May 5, 2000, data request. In its Reply Comments, IBT states that it had provided responses that would demonstrate IBT satisfied service quality standards.

IBT included no exogenous change factor in its filing. The Z factor accounts for any impact associated with changes made to the Federal Communications Commission's ("FCC") rules, and/or with some other change which is quantifiable and outside IBT's control, and has not been picked up in the economy wide inflation factor. Staff concluded that a request by IBT for no exogenous factor treatment was appropriate.

COMMISSION CONCLUSION

For both the Service Quality factor and Exogenous Change factor a value of 0 is appropriate for calculating PCI.

V. WHOLESALE RATE CHANGE CALCULATIONS

IBT had originally proposed changing rates for wholesale services in this filing. Staff argues that IBT did not provide calculations showing that these rate changes were made appropriately. Staff expressed significant concerns relative to the wholesale rate changes and in Staff's view, the changes lacked the requisite support.

Upon reconsideration, IBT has elected to voluntarily withdraw in its July, 2000, filing, the two increases it proposed to wholesale rates.

VI. MERGER RELATED SAVINGS

In Docket 98-0555 ("Merger Order") the Commission ordered that IBT track all merger related costs and savings between the date the merger was consummated, October 8, 1999, and December 31, 1999. IBT was then ordered to submit information relating to the tracking of such costs and savings as part of the Alternative Regulation filing due April 1, 2000, Docket 98-0252. Pursuant to the Merger Order, information on merger related costs and savings are to be submitted annually with IBT's annual price cap filings until an updated price cap formula is developed in 98-0252. In the Merger Order the Commission required the retention of a third party auditor to develop and establish accounting standards so that the Commission could identify merger related costs and savings. In the event there are merger related savings, 50% of those saving allocable to IBT are to be allocated to Illinois ratepayers.

IBT in its annual filing, identified 1.2 million dollars as it's net costs for the period ending December 31, 1999. CUB/AG contend there is insufficient detail as to how IBT calculated these amounts or determined which accounts were affected by the merger. With respect to the independent audit, the results thereof are not expected to be completed until September, 2000.

CUB/AG contend that without the ability to cross examine witnesses specifically related to merger related costs or savings, they are denied due process.

With respect to merger related costs and savings, CUB/AG propose that the procedural rules for annual filing dockets be amended to accommodate a traditional contested hearing format and that rates be set temporarily until the completion of a proposed phase two. In its proposed phase two, CUB/AG suggest that there would be a full hearing examining the calculation of merger costs and savings. In the event that

phase two would result in a finding where savings exceeded costs, IBT acknowledges that the Commission could require IBT to retroactively adjust its rates.

IBT argues that examination of merger related costs and savings should be done in an independent docket. IBT reasons that the mechanism for sharing merger related saving with retail customers and carriers would be done through updated cost studies and an allocation of savings between interexchange carriers and end users. That being the case, IBT surmises that that mechanism falls outside the scope of this filing. Additionally, IBT expresses its concern that a phase two procedure could impede expedited review of traditional rate filing issues by forcing the docket to remain open, potentially indefinitely.

COMMISSION CONCLUSION

CUB/AG correctly acknowledge that the procedural framework established for annual filing dockets does not permit parties the opportunity to present evidence on the issue of the calculation of merger related savings. The calculation of merger related cost and savings figures is no small task. As CUB/AG recognizes, the gargantuan task of calculating cost and savings figures involves the difficult and time-consuming process of establishing accounting standards and sifting through the accounting records of the newly merged company. A task of this magnitude is ill suited for an annual filing docket wherein initial filings occur on or before April 1 of each year and wherein an order must be entered by July 1 of each year.

To require that this docket remain open until the issue of merger related costs or savings is ultimately resolved is not practical. What is appropriate is that upon completion of the independent audit, this Commission shall open a separate proceeding in accordance with the "contested case" provisions of the Illinois Administrative Procedure Act, 5 ILCS 100 1/1 et seq. separate docket specifically created for merger related costs and savings will ensure that the due process concerns of both CUB/AG and IBT are properly addressed. CUB/AG, Staff, IBT, and other Intervenor will have the opportunity to fully explore the accounting standards developed in the independent audit, conduct discovery, present and cross-examine witnesses at a hearing, and submit briefs to the Commission.

Finally, by addressing merger related savings in a separate docket, IBT, Staff, CUB/AG and other Intervenor will retain the ability to have an expedited review of traditional annual rate filing issues in this annual filing docket.

VII. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record herein, and being fully advised in the premises thereof, is of the opinion and finds that:

- (1) Illinois Bell Telephone Company is an Illinois corporation engaged in the business of providing telecommunications services to the public in the State

of Illinois and, as such, is a telecommunications carrier within the meaning of Section 13-202 of the Illinois Public Utilities Act:

- (2) the Commission has jurisdiction over Illinois Bell Telephone Company and the subject matter of this proceeding;
- (3) the recital of facts and law and conclusions reached in the prefatory portion of this Order are supported by the record, and are hereby adopted as findings of fact and conclusions of law for purposes of this Order;
- (4) Illinois Bell Telephone Company's proposal calculation of the PCI is correct;
- (5) Staff and CUB/AG recalculation of the API formula is rejected for reasons set forth herein;
- (6) Illinois Bell Telephone Company should be required to file new tariffs reflecting a PCI consistent with the determination and conclusions herein;
- (7) there exists the need for an independent examination of merger related costs and savings as they become available from the required independent audit pursuant to Commission order in Docket 98-0855;
- (8) a separate docket is an appropriate mechanism to review merger related savings and costs and the Commission shall open such a docket in order to permit a full and fair hearing in accordance with the contested case provisions of the Illinois Administrative Procedure Act.
- (9) In future filings, IBT shall provide documentation of the changes to the API that occur during the course of the year and shall do so in its initial comments similar in form to Attachment 4 of IBT's reply comments. IBT shall also include the recalculation of the proposed and current revenue for each time the API changes over the course of the year, similar in form to Exhibit 5 of its initial comments.

IT IS THEREFORE ORDERED that Illinois Bell Telephone Company shall within 14 days of entry of this Order, file tariffs reflecting a PCI for 1999-2000 consistent with the findings and conclusions hereinabove, and with all other terms and conditions of the Order in Docket 92-0448/93-0239 Consolidated, including, but not limited to a demonstration that each service basket API is less than or equal to the PCI, and a demonstration of compliance with Sections 13-505.1 and 13-507 of the Act.

IT IS FURTHER ORDERED that in future filings, IBT shall provide documentation of the changes to the API that occur during the course of the year and shall do so in its initial comments. IBT shall also include in its initial comments the recalculation of the proposed and current revenue for each time the API changes over the course of the year.

IT IS FURTHER ORDERED that upon completion of the independent audit of merger related costs and savings as required by Commission order in Docket 98-0555, the Commission shall cause to open a separate docket in order to fully explore the results of the audit of merger related costs and savings and to implement savings sharing, if any.

IT IS FURTHER ORDERED that Illinois Bell Telephone Company shall include a narrative description of its pricing proposals for each service basket; and shall provide a copy of its filing in the offices of the Commission in Chicago and Springfield on the day of filing for the purpose of public inspection and copying.

IT IS FURTHER ORDERED, that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this 27th day of June , 2000.

(SIGNED) RICHARD L. MATHIAS

Chairman

(SEAL)